Republic of the Philippines
Department of Finance
Securities and Exchange Commission
COMMISSION EN BANC

GOLDSTAR SECURITIES, INC.
Appellant,

-versus-

SEC En Banc Case No. 02-14-316

MARKETS AND SECURITIES REGULATION DEPARTMENT,

Appellee.
X---x

DECISION

For consideration of this Commission is the Memorandum on Appeal dated 4 February 2014 which was filed on 5 February 2014 by Appellant Goldstar Securities, Inc. (Goldstar), praying that the En Banc reverse the Letter-Decision dated 13 August 2013 of the Commission's Market Regulation Department (MRD), now Markets and Securities Regulation Department (MSRD), imposing a fine for material deficiencies and material misstatements in Goldstar's FY 2010 Audited Financial Statements (AFS).

RELEVANT FACTS

Appellant Goldstar is a company engaged in the brokerage business of stocks, bonds, and other financial securities and in all activities directly or indirectly connected therewith or incidental thereto and to be a member of any stocks or commodity exchange as well as board of realtors, national, regional or local. As with all corporations, Goldstar is obligated to submit its AFS to the Commission.

On 06 April 2011 Goldstar filed with the Commission its AFS for the year ended 31 December 2010 (2010 AFS) duly audited and certified by its independent public accountant and stamped "received" by the Bureau of Internal Revenue.

On 26 March 2013, the MSRD issued a letter directing Goldstar to show cause why it should not be held liable for material deficiencies in its AFS and for non-compliance with the requirements of the rules on audited financial statements of the Commission pursuant to SRC Rule 68, as amended, and be penalized in accordance with SEC MC No. 8, series of 2009.

The show-cause letter alleged the following deficiencies in Goldstar's 2010 AFS:

a. Appropriation of Reserve Fund – Based on Note 23.2 of the AFS, the Company appropriated Php1,944,176. Said appropriation appears to be deficient by Php972,088 per our computation considering that its unimpaired paid-up capital for the year 2010 is Php30,000,000 [Rule 49.1 (B) and SEC Memorandum Circular No. 16, series of 2004].

b. General and Administrative (G&A) Expenses – There is no explanatory note on "Others" amounting to Php3.06 Million per Note 16 (PAS1).

In response to the show cause letter, Goldstar filed on 16 April 2013 a letter-reply explaining that:

a. The appropriation made for 2010 is in order at 20% of audited net income considering that its total paid up capital was Php30Million.
b. "Others" under the (G & A) expenses consists of various expenses with amounts that are in the range of less than 1% to 4% of the total G & A expenses such as year-end expense, miscellaneous expense, cultural and sports expense, system development cost, membership fees and dues, postage and courier services, and advertisement and publication, messengerial, janitorial and security services, and fines and penalties which are immaterial.

In its Letter-Decision dated 13 August 2013, the MSRD found the reasons proffered by Goldstar insufficient because it failed to raise reasonable and substantial grounds to reverse MSRD's findings on the materiality of the deficiency in its AFS, and thus imposed a penalty in the amount of Eighteen Thousand Pesos (P18,000.00).

On 16 August 2013, Goldstar filed another letter reiterating its position that the appropriation made for 2010 which was 20% of its profit after tax is consistent with SEC Memorandum Circular No. 16, series of 2004. Goldstar also provided a breakdown of its "General and Administrative Expenses – Others", the amounts of which were allegedly within the range of less than 1% to 4% of the total G&A expenses. On the basis of the foregoing, Goldstar maintains that it does not merit the monetary sanction imposed by MSRD.

In compliance with the Order dated 21 January 2014 issued by the Commission, Goldstar filed the instant Memorandum on Appeal.

On 12 February 2014, MSRD filed its Reply Memorandum in compliance with the Order dated 06 February 2014 of the Commission. MSRD emphasized that Goldstar's assertion that it merely exercised the option granted to determine the percentage to be applied in settling for 20% of its profit after tax is without merit and basis because it disregarded SRC Rule 49.1 (H)(I)(B) which mandated that the choice for the appropriate treatment of financial transactions should be that which would provide a more conservative computation of the RBCA ratio. MSRD thus prayed for the dismissal of Goldstar's Memorandum on Appeal.

ISSUE

The sole issue is whether MSRD was correct in imposing the monetary penalty against Goldstar.

DISCUSSION

We find the instant appeal bereft of merit.

On Appropriation of Reserve Fund

Rule 49.1 (B)(1) of SEC Memorandum Circular No. 16, series of 2004 (MC No. 16), also known as the Risk-Based Capital Adequacy (RBCA) Rules, requires the establishment of a reserve fund, to wit:

> "(1) Every Broker Dealer shall annually appropriate a certain minimum percentage of its audited profit after tax and transfer the same to the Appropriate Retained Earnings Account in accordance with the following schedule:

x--x

Unimpaired Paid Up Capital	Minimum percentage or profit after tax to be place in the Appropriated Retained Earnings
Between 10-30	30%
Between 30-50	20%
More than 503	10%"

In its 2010 AFS Goldstar reported a total paid-up capital of Thirty Million Pesos (P30,000,000.00). Under the RBCA Rules, Goldstar could either appropriate thirty percent (30%) or twenty percent (20%) of its audited profit after tax and transfer the same to its Reserve Fund. Records reveal that for the year 2010, Goldstar opted to use 20% of its audited net income which amounted to Php1,944,176.00[1] for purposes of complying with MC No. 16. In support of the foregoing, Goldstar contends that it (as well as other broker dealers similarly situated) was granted liberality to choose between the 20% or 30%, and it cannot thus be held liable for exercising the option given to it.

The contention of Goldstar that it has been granted the option to determine which percentage to apply in the determination of its Reserve Fund is patently misplaced and without legal basis. The Commission agrees with the MSRD that Rule 49.1(B) of MC No. 16 should be read and applied in the context of SRC Rule 49.1 (H)(I)(B) of the RBCA Rules (RCBA Rules) which provides that:

> "The RBCA Rules should be applied and understood in relation to the Securities Regulation Code (SRC) and its implementing rules and regulations. In case of doubt, the RBCA rules should be interpreted in a manner that is consistent with the SRC and its implementing rules and regulations and international best practices in financial services regulation. When in need of policy direction or legal interpretation, the Broker Dealer must seek guidance from the Commission's Market Regulation Department. **In choosing the appropriate treatment of financial transactions which impact on the RBCA computation, the choice should be that which would provide a more conservative computation of RBCA ratio.**" (Emphasis supplied)

The afore-quoted provision negates Goldstar's position that it has the option to determine the amount representing the percentage of its audited profit after tax prescribed under MC No. 16 to be set aside and to form part of its annual Reserved Fund because the mandate and intent of the said provision is clear i.e. "the choice should be that which would provide a more conservative computation of RCBA ratio." Simply put, given the option of choosing between 20% and 30%, the RCBA Rules mandate that with a reported total paid-up capital of Thirty Million Pesos (P30,000,000.00),

[1] Net profit after tax multiplied by 20% (P9,720,882.00 x 20%); Note 23.2 of Goldstar's 2010 Audited Financial Statements

Goldstar should have chosen 30% instead of 20% in computing for the amount to be appropriated to the Reserve Fund because the same would lead to or result in a more conservative computation.

On Explanatory Note on General and Administrative Expenses - Others

SEC MC No. 8, Series of 2009 (MC No. 8) provides that the materiality of the deficiency, misrepresentation or misstatement in the financial statements shall be based on the tests set and provided therein by the Commission in, to wit:

> "III. Test of Materiality
>
> A. The following shall be considered a material deficiency in the financial statements (FS) or significant non-compliance with SRC Rue 68:
>
> xxx
>
> (iv.) There is no accounting policy for a significant account;
>
> For purposes of these Guidelines, a **significant account means a Balance Sheet or Income Statement item, the amount of which is equivalent to:**
>
> **xxx**
>
> **(6) 5% or more of the Gross Income, Cost of Sales/Services or the Total Operating Expenses, as may be applicable.**
>
> **For all other corporations, the threshold shall be 10% or more of the items mentioned above."** *(Emphasis supplied)*

Goldstar insists that it correctly presented its "General & Administrative (G&A) Expenses – Others" in its total amount without any breakdown or other disclosures/explanatory notes for the reason that the same consisted of various expenses with involving minimal or insignificant amounts in the range of less than 1% to 4% of the total G&A Expenses. The Commission is not persuaded.

Pursuant to MC No. 8, the basis should have been the total G&A Expenses – Others vis-a-vis the Total Operating Expenses.

The 2010 AFS of Goldstar shows that the G & A Expenses - Others amounted to Three Million Sixty Thousand Ninety Seven Pesos (P3,062,097.00)[2] while the Total Operating Expenses of Goldstar for 2010 amounted to Twelve Million Two Hundred Nine Thousand Two Hundred Ninety Two Pesos (Php12,209,292.00)[3]. The G&A Expenses – Others constituted twenty-five percent (25%) of the Total Operating Expenses and

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[2] Note 16 of the 2010 Audited Financial Statements of Goldstar
[3] *Ibid.*

clearly falls within the definition of a significant account under MC No. 8. As a significant account, the same should have been disclosed and included in the AFS, which Goldstar clearly failed to do.

The Commission agrees with the observation of MSRD that Goldstar's act of providing the required disclosures/explanatory notes/breakdown of its G&A Expenses – Others amounting to P3.06 Million after the show-cause letter issued by the MSRD, cannot negate the fact that its 2010 AFS did not comply with the requirement of SRC Rule 68[4] and MC No. 8.

Finally, the argument of Goldstar that it immediately complied in good faith with the requirement of providing the coverage of the questioned item does not persuade. It bears emphasis that the defense of good faith is immaterial and irrelevant to violations of the financial reporting requirements of the Commission. Good faith or bad faith hardly comes into the picture in the enforcement of simple rules mandating submission of reportorial requirements. To allow legal notions to intrude at every level in the implementation of these rules would defeat their very purpose, as every penalty could be subject to question and every violation based on a clear-cut rule would be qualified by the presence or absence of good faith or bad faith, or the question of motive or intent.[5]

The foregoing violations of the Commission's rules on AFS warrant the imposition of the following penalties under the MC No. 08, thus:

Violations	Basis of Penalty	Remarks	Amount
1. Material deficiencies in the financial statements and non-compliance with SRC Rule 68.	Section III (A) (iv) of Memorandum Circular No. 8, series of 2009 in relation to Section I (E)	First Offense	P9,000.00[6]

[4] "The Commission shall have the authority to make, amend, and rescind such accounting rules and regulations as may be necessary to carry out the provisions of this Code, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical and trade terms used in this Code. Among other things, the Commission may prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and income statement, and the methods to be followed in the preparation of accounts, appraisal or valuation of assets and liabilities, determination of depreciation and depletion, differentiation of recurring and non-recurring income, differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with, the issuer."

[5] In re Clearwater Country Club, Inc., SEC EN Banc Case No. 08-07-111, March 25, 2010

[6] Retained Earnings for FY 2010 is P53,177,055.00

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(For failure to provide the required disclosures on G&A Expenses-Other)			
2. Material misstatement in the financial statement (For insufficient appropriation of Reserve Fund)	Section III (B) of Memo Circular No. 8, Series of 2009 in relation to Section I (E)	First Offense	P9,000.00[7]

WHEREFORE, premises considered, the Letter-Order dated 13 August 2013 issued by the Markets and Securities Regulation Department (MSRD) is hereby AFFIRMED and the instant appeal is DENIED for lack of merit. Consequently, the Appellant Goldstar Securities, Inc. is hereby DIRECTED TO PAY the assessed penalty of EIGHTEEN THOUSAND PESOS (P18,000.00) within ten (10) days from receipt of this Decision.

SO ORDERED.

Pasay City, Philippines; 10 December 2019

EMILIO B. AQUINO
Chairperson

EPHYRO LUIS B. AMATONG
Commissioner

JAVEY PAUL D. FRANCISCO
Commissioner

KELVIN LESTER K. LEE
Commissioner

KARLO S. BELLO
Commissioner

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[7] P9,720,882.00 x 10% = P972,088 Deficiency in appropriation
1/10 of 1% of deficiency amount = P972.08 or amount based on the above scale (material deficiency) = P9,000, whichever is higher